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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

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CC:CORP:02

PLR-131012-08

Date:

September 16, 2008

LEGEND

Distributing =

State X =

Year 1 =

Date 1 =

A Shareholder Group =

B Shareholder Group =

W =

X =

Y =

Business 1 =

Business 2 =

Business 3 =

Dear :

This letter responds to your July 10, 2008, request for rulings on certain federal income tax consequences of a series of proposed transactions. The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the proposed transactions described below: (i) satisfy the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) are being used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) are part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e) and § 1.355-7).

SUMMARY OF FACTS

Distributing is a State X corporation that was organized as a subchapter C corporation in Year 1. On Date 1 (less than 10 years ago), Distributing elected to be taxed as a subchapter S corporation for federal income tax purposes. Distributing has one class of common stock that is owned w percent by the A Shareholder Group and x percent by the B Shareholder Group.

Distributing is engaged in Business 1 and Business 2 (together "Business 3") and has submitted financial information indicating that Business 1 has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The A Shareholder Group and the B Shareholder Group have decided to go their separate ways so that each may operate its portion of Business 3 in accordance with its own management philosophy.

PROPOSED TRANSACTIONS

For what are represented to be valid business reasons, Distributing has proposed the following transactions (the “Proposed Transactions”):

- (i) Distributing will contribute y of its Business 1 assets, y of its Business 2 assets, and cash (the “Contributed Assets”) to a newly-formed State X corporation (“Controlled”) in exchange for all of the outstanding shares of Controlled stock and the assumption by Controlled of the liabilities associated with the assets transferred (the “Contribution”). If the fair market value of the contributed Business 1 and Business 2 assets changes before the Proposed Transactions are completed, the amount of cash included in the Contribution will be adjusted to reflect such change. This adjustment could occur before the Distribution but may not be determinable until later, in which case an amount will be paid either by Distributing to Controlled or by Controlled to Distributing after the Distribution (the “Post-Closing Cash Adjustment”). Any adjustment is not expected to be significant.
- (ii) Distributing will transfer to Controlled the local managerial and operational employees associated with the transferred Business 1.
- (iii) Distributing will distribute all of the Controlled stock to the B Shareholder Group in exchange for all of the Distributing stock held by the B Shareholder Group (the “Distribution”).

In connection with the Proposed Transactions, Distributing and Controlled will enter into various agreements for issue resolution, support, and transitional services. These agreements will include a tax matters agreement and a corporate services agreement (the latter, the “Services Agreement”).

REPRESENTATIONS

The taxpayer makes the following representations regarding the Proposed Transactions:

- (a) Any indebtedness owed by Controlled (or any entity controlled directly or indirectly by Controlled) to Distributing (or any entity controlled directly or indirectly by Distributing) after the Distribution will not constitute stock or securities.

- (b) The fair market value of the Controlled stock and any other consideration received by each member of the B Shareholder Group will be approximately equal to the fair market value of the Distributing stock surrendered by the member in the exchange.
- (c) No part of the consideration distributed by Distributing will be received by a shareholder as a creditor, an employee, or in any capacity other than that of a shareholder of Distributing.
- (d) The five years of financial information submitted on behalf of Business 1 that will be conducted by Distributing immediately after the Distribution represents its present operation, and with regard to that business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) The five years of financial information submitted on behalf of Business 1 that will be conducted by Controlled immediately after the Distribution represents its present operation, and with regard to that business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Neither Business 1 nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (g) Apart from continuing transactions under the Services Agreement, following the Distribution, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing before consummation of the transaction.
- (h) The Distribution is being carried out for the following corporate business purpose: to enhance the success of Business 3 by enabling each shareholder group to operate its share of the business in accordance with its own management philosophy. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (i) The Distribution will not be used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

- (j) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (k) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (l) The total adjusted basis and the fair market value of the assets that will be transferred to Controlled in the Contribution will equal or exceed the sum of (i) the total liabilities to be assumed (as determined under § 357(d)) by Controlled and (ii) the total amount of any money and the fair market value of any other property (within the meaning of § 361(b)) received by Distributing from Controlled and transferred to Distributing's creditors in connection with the reorganization.
- (m) The liabilities to be assumed (as determined under § 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (n) The total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.

- (o) Distributing will neither accumulate its receivables nor make extraordinary payment of its payables in anticipation of the Distribution.
- (p) No intercorporate debt will exist between Distributing (or any entity controlled directly or indirectly by Distributing) and Controlled (or any entity controlled directly or indirectly by Controlled) at the time of, or after, the Distribution, other than intercompany loans or obligations that have arisen, or will arise, between the parties in the ordinary course of business or as a result of the Services Agreement.
- (q) Payments made in connection with all continuing transactions (including under the Services Agreement) between Distributing (or any entity controlled directly or indirectly by Distributing) and Controlled (or any entity controlled directly or indirectly by Controlled) will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (r) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).
- (s) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (t) Immediately after the transaction (as defined in § 355(g)(4)), neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).
- (u) Effective Date 1, Distributing made an election under § 1362(a) to be an S corporation (within the meaning of § 1361(a)), and Distributing has continued to be an S corporation since Date 1 (within the meaning of § 1361(a)).
- (v) Immediately after the Distribution, Controlled will be eligible to elect S corporation status pursuant to § 1362(a), effective immediately after the Distribution.
- (w) Controlled will elect to be treated as an S corporation, effective immediately after the Distribution (see § 1.1361-3(a)(4)).

- (x) None of the persons holding stock, membership interests, or any equity interest in either Distributing or Controlled is a nonresident alien individual, a foreign corporation, or a trust (except for trusts meeting the requirements of § 1361(c)(2)).
- (y) There is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

RULINGS

Based solely on the information submitted and the representations set forth above, we rule as follows:

- (1) The Contribution, followed by the Distribution, will be a reorganization under § 368(a)(1)(D). Distributing and Controlled will each be “a party to the reorganization” under § 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(b)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (4) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).
- (5) The basis of each asset received by Controlled in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution (§ 362(b)).
- (6) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (§ 1223(2)).
- (7) No gain or loss will be recognized by (and no amount will otherwise be included in the income of) any member of the B Shareholder Group on the Distribution (§ 355(a)(1)).
- (8) The aggregate basis that each member of the B Shareholder Group has in his or her Controlled stock immediately after the Distribution will equal the member’s aggregate basis in the Distributing stock immediately before the Distribution (§ 358(a)).

- (9) The holding period of the Controlled stock received by each member of the B Shareholder Group will include the holding period during which the member held the Distributing stock for which the Controlled stock is exchanged, provided that the Distributing stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) Earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h) and § 1.312-10(a).
- (11) Any Post-Closing Cash Adjustment made between Distributing and Controlled that (i) has arisen or will arise for a taxable period on or before the Distribution or for a taxable period beginning before and ending after the Distribution and (ii) will not become fixed and ascertainable until after the Distribution, will be treated as occurring before the Distribution (*cf. Arrowsmith v. Commissioner*, 344 U.S. 6 (1952); Rev. Rul. 83-73, 1983-1 C.B. 84).
- (12) Controlled will be subject to § 1374 with respect to any asset transferred from Distributing to Controlled to the same extent that Distributing is subject to § 1374 with respect to such asset. For purposes of § 1374, Controlled's recognition period will be reduced by the portion of Distributing's recognition period that expires prior to Distributing's transfer of these assets to Controlled (§ 1374(d)(8) and Ann. 86-128, 1986-51 I.R.B. 22).
- (13) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be eligible to elect to be a subchapter S corporation under § 1362(a) for its first taxable year.
- (14) Distributing's accumulated adjustments account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under § 312(h) (see § 1.312-10(a) and § 1.1368-2(d)(3)).

CAVEATS

No opinion is expressed about the tax treatment of the Proposed Transactions under other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of § 1.355-2(b);

- (ii) Whether the Distribution will be used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both; and
- (iii) Whether the Distribution will be part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii).

PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Virginia S. Voorhees
Senior Technician Reviewer, Branch 5
Office of Associate Chief Counsel (Corporate)